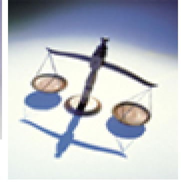
The Weekly Update of Texas Insurance News

TEXAS INSURANCE LAW NEWSBRIEF



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HOUSTON FEDERAL DISTRICT COURT EVALUATES CONSTRUCTION DEFECT COVERAGE CLAIMS AFTER LAMAR HOMES AND THE AVAILABILITY OF CONTRIBUTION/SUBROGATION CLAIMS BETWEEN INSURERS

Last week, a Federal District Court in Houston evaluated several fairly significant construction defect coverage issues and the resulting availability of contribution and subrogation claims by those liability insurers paying the defense of a covered tort claim against a non-participant. In *Trinity Universal Ins. Co., et al. v. Employers' Mutual Ins. Co.*, C.A. No. H-07-0878 (May 15, 2008), U.S. District Court Judge Ewing Werlein tackled several significant construction defect coverage issues in light of the Texas Supreme Court's recent decision in *Lamar Homes* as well as an insurer's right to seek contribution or subrogation from another insurer not participating in the defense of the insured following the Texas Supreme Court recent decision in *Mid-Continent v. Liberty Mutual*. The insureds for the liability insurers in this litigation, Lacy Masonry, were sued by McKenna Memorial Hospital for allegedly defective design, construction and improvement to various hospital buildings resulting in water infiltration problems. This coverage suit was brought by two of the insured's liability carriers who had assumed the defense of the insured against a third carrier who had refused to defend.

With respect to the non-participating carrier's (Employers') duty to defend, the Court was required to evaluate a "designated work" exclusion contained in a manuscript EIFS exclusion. Because the court found the EIFS exclusion only excluded property damage claims arising out of work on the *exterior* of the building, it found Employers had a duty to defend because the underlying petition alleged *interior* damage at the hospital which did not fall within the EIFS exclusion.

The Employers' policy also limited coverage to property damage occurring during the policy period. When Employers refused to defend because the underlying petition failed to state *when* the defective construction occurred or when the resulting property damage manifested, the Court was required to evaluate whether it could consider extrinsic evidence. Employers sought to introduce evidence obtained in discovery in the underlying construction defect case establishing that both the construction and the manifestation of damages occurred *prior to* the inception of the policy. The District Court refused to consider such extrinsic evidence under guidelines recently set forth by the Texas Supreme Court because such evidence "overlaps with the merits of the underlying lawsuit." Because the extrinsic evidence which Employers sought to use was produced during discovery in the underlying case and overlapped with the merits of the hospital's claims, the evidence which Employers wanted to use was held by the Court to go "to the heart of the insured's limitations defense" and so the Court found the extrinsic evidence "inadmissible." Because of the ambiguity in the pleadings regarding a trigger of coverage date, the Court found the *potential of coverage* triggered Employers' duty to defend.

The most interesting part of the District Court's decision dealt with the determination of whether of whether the co-insurers had a contribution or subrogation claim against Employers for its failure to defend the insured. The Court had to interpret and apply the Texas Supreme Court's recent decision in *Mid-Continent Ins. Co. v. Liberty Mutual*, 236 S.W.3d 765 (Tex. 2007). Despite the plaintiff carriers' arguments that the *Mid-Continent* case should be narrowly construed, the District Court found that it directly applied to preclude both the contribution

claims by the participating carriers against Employers as well as their subrogation claims. Because the carriers did not obtain an assignment from the insured, the Court found the participating carriers had no direct action against Employers under Texas law. As such, the District Court held the participating carriers could not recover through subrogation or contribution any portion of the defense costs that should have initially been paid by Employers. As such, even though Employers owed a duty to defend going forward, the participating carriers were not entitled to reimbursement of the sums the Employers should have paid had it timely assumed the defense with the other participating carriers.

Editor's Note: The *Mid-Continent vs. Liberty* case continues to perplex Texas insurers. There are ways a participating liability insurer can assert a reimbursement claim against a non-participating carrier in Texas, but it takes far more work to properly set it up than in other states where one carrier can just sue the other for contribution or subrogation. The "Texas Two-Step" now required after Mid-Continent usually requires an assignment or other participation from the insured before the direct action can be brought against the non-participating carrier. It had been hoped by several recent commentators that *Mid-Continent* would be narrowly construed by subsequent Texas courts, but Judge Werlein's decision shows how difficult that may be given the broad language used by Texas' high court in *Mid-Continent*.

TEXAS SUPREME COURT RULES ATTEMPTED REMOVAL TO FEDERAL COURT OR TRANSFER TO ANOTHER VENUE DOES NOT WAIVE ARBITRATION AGREEMENTS

Last week, the Texas Supreme Court considered a mandamus raising the issue of whether the attempted removal of a case to federal court or transfer to another venue waives contractual arbitration agreements. *In re City Group Global Markets*, the Texas Supreme Court ruled on Friday that a defendant's efforts to remove a case to federal court or seeking to transfer a case to a Multi-District Litigation court in another forum do <u>not</u> constitute a waiver of contractual arbitration provisions and it accordingly directed the trial court to compel arbitration.

AMARILLO COURT OF APPEALS DETERMINES TEXAS WINDSTORM INSURANCE ASSOCIATION CAN BRING DECLARATORY JUDGMENT ACTIONS AGAINST INDIVIDUAL INSUREDS

Last week, the Amarillo Court of Appeals ruled the Texas Windstorm Insurance Association could bring a declaratory judgment action against insureds who demanded appraisal because the insureds were dissatisfied with the determination of the benefits arising out of the adjustment of their Hurricane Rita claim in Port Arthur, Texas. In *Texas Windstorm Insurance Association v. Poole*, 2008 Westlaw 2065107, ___ S.W.3d __ (Tex.App.—Amarillo, May 15, 2008), the TWIA brought a DJ action in response to the insured's demand for appraisal. The insureds moved to dismiss arguing they were the only ones who could bring suit. After the trial court agreed, TWIA appealed.

This dispute caused the Amarillo Court of Appeals to evaluate the scope of the Texas statutes creating this entity. Although it noted that TWIA "has attributes of a private insurance business while operating under a governmental cloak," it recognized that it was exercising quasi-governmental powers on behalf of the State and part of its grant of powers included the ability to seek resolution of "legal entanglements." To bar TWIA's ability to bring suit would "impede its ability to fulfill the purpose or charge placed on it by the Legislature." As such, the court determined TWIA can bring declaratory judgment actions against its insureds under the statutory grant of authority provided by the Texas Legislature.

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